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NO. 195

IN THE

Supreme Court of the United States

October Term 1961

A. C. WILLINGHAM, *Petitioner*

v.

THE UNITED STATES OF AMERICA, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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v.

THE UNITED STATES OF AMERICA, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner A. C. Willingham prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above entitled case (No. 18,381 below).

CITATION TO OPINION BELOW

The opinions of the Court of Appeals (R. 353-365; 402-403), printed in Appendix B hereto, *infra*, p. 21, are reported at 289 F. 2d 283. The District Court did not render an opinion.

JURISDICTION

The judgment of the court below affirming the judgment of the trial court was dated and entered April 20, 1961. Petition for rehearing was filed which was denied by judgment entered on June 2, 1961. Jurisdiction of this Court is invoked under 62 Stat. 928, 28 U.S.C. Sec. 1254 (1) and Supreme Court Rule 22(2).

QUESTIONS PRESENTED

The questions which are the basis for this petition for writ of certiorari are:

1. Whether under the 1939 Revenue Code a corporate operating loss will carry forward through a Chapter X corporate reorganization in bankruptcy so as to affect tax liability for a subsequent year.

2. Whether a subsequent operating loss will carry back to an indictment year so as to produce a tax overpayment and preclude conviction for attempt to evade income tax for such year.

STATUTES AND RULES INVOLVED

The statutory provisions relied on as the basis for writ of certiorari are I.R.C. 1939 Subchapter C, Supplement B, Section 122(2) (b) (B), 53rd Statute 867 as amended by the Revenue Act of 1950, 64 Stat. 906 Section 215; I.R.C. 1939, Chapter C, Supplement B, Section 122(2) (b) (C), as amended by the Revenue Act of 1951, 65 Stat. 452, Section 330; U.S.C.A. Title 11, Chapter X, Sec. 668, 52 Stat. 904; U.S.C.A. Title 11, Chapter X, Sec. 670, 52 Stat. 904, as amended, 54 Stat. 709; I.R.C. 1939, Sec. 129(a), 58 Stat. 47; I.R.C. 1939, Sec. 145(b), 53 Stat. 62; I.R.C. 1954; and U.S.C.A. Title 26, Sec. 172(b) (1) (A), 68A Stat. 63.

STATEMENT OF THE CASE

Petitioner was convicted by a jury trial under two counts of an indictment which charged him as president of Gulf Southwestern Transportation Company with attempted evasion of income tax by the filing of false returns for that company for the years 1952 and 1953. The indictment alleges that for 1952 there was a tax paid of $5,034.24, whereas tax due was $15,932.80; for 1953, a tax paid of $5,839.68 and tax due of $24,937.13 (R. 8). The Government made its case with proof of "specific acts" as distinguished from proof of net worth before and after the indictment years (R. 86-92). Petitioner was sentenced to serve three years in the penitentiary under each count, with such sentences to be served concurrently. He was fined $5000 (R. 565, App. B).

It was Petitioner's defense that he was not guilty of the offense charged because Gulf Southwestern sustained operating losses in 1949, 1950 which should have been but were not carried forward to 1952 and 1953 by the accountant who prepared the returns for both years* (R. 108-154). The amount of the losses was such that *even after adjustment of the corporate income* by increasing it in the full amount of the "specific acts" in controversy there was still an *overpayment* of tax for both years (Bill of Exception, R. 205-254). Also Petitioner offered proof of operating

*The full statement of facts with respect to the evidence which was offered by Petitioner and reply thereto by the Government as to Petitioner's operating losses and details of the reorganization intervening between the years of loss and the indictment years was developed by bill of exception. The bill was submitted on affidavits of Petitioner's witnesses and reply by affidavits from the Government's witnesses pursuant to direction of the trial court (R. 158-159). None of the evidence outlined herein was permitted to go to the jury.

losses in 1955 which carry back in an amount which, without the aid of carry-over loss from prior years, is sufficient to wipe out the "specific acts" deficiency for 1953 and result in overpayment for that year (R. 148, 208).

All of the evidence which was offered to show operating loss carry-over was excluded by the Court on objection by the Government because of a Chapter X reorganization of Gulf Southwestern which occurred in 1952 (R. 154-158). The reorganization decree recited that the corporation was insolvent and that there was, therefore, no equity for the stockholders (R. 242, et seq.). It provided that stock of the company belonging to minority stockholders would be canceled and that the balance would be owned in its entirety by Culberson, a majority stockholder. Culberson undertook, on behalf of the corporation, to pay a first mortgage lien against the assets of the corporation which was held by The First National Bank of Fort Worth, Texas, all state, county and municipal taxes in full, other claims, including the United States Government in the amount of $7000 and ten per cent of the claims of ordinary unsecured creditors.

The decree further provided that on the payment of these claims pursuant to the plan, all debts would be wiped out.

Concurrently with processing of the proposal for reorganization of the company, Culberson agreed with Petitioner, subject to approval of the plan of reorganization, to sell his stock in Gulf Southwestern to Petitioner for $79,000. This transaction was part cash, part credit, and contemplated the sale of the terminal properties of Gulf

Southwestern at Dallas, with the application of the proceeds of that sale to retirement of the first mortgage in favor of The First National Bank of Fort Worth (R. 306, et seq.). By this contract, Petitioner agreed to cause five per cent of the gross receipts of the company to be paid to Culberson until the purchase price of the stock acquired from Culberson had been paid for in full. The motor carrier operations of the corporation, which were its only business purpose, were continued pursuant to its interstate and Texas operating certificates in the same manner before and after reorganization (R. 242-251).

Gulf Southwestern was operated as a corporate entity before reorganization and its corporate entity was maintained thereafter (Government's Ex. 8; R. 48, 106-114). Petitioner was indicted as an officer of Gulf Southwestern.

It was the theory of the trial court in rejecting all evidence offered to establish operating loss carry-over that before and after the Chapter X reorganization Gulf Southwestern was not "the same taxpayer." Therefore the prior corporate losses were held to be unavailable under I.R.C. 1939(b)(2)(B)(C), which extend the carry-over privilege to "the taxpayer" sustaining the loss (R. 154-158). An offer of proof of carry-back losses for 1955 was excluded by the Court on the theory that the act of attempted evasion was complete when the return was filed and could not be affected by a subsequent operating experience of the company (R. 148). These rulings were sustained by the Fifth Circuit opinion.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

1. In its ruling on the loss carry-overs the Court of Appeals has decided an important question of federal law

which has not been but should be settled by this Court.

2. In its ruling on the carry-backs the Court of Appeals has rendered a decision which is in conflict with decisions of this Court and with the ruling of another Court of Appeals on the same subject.

ARGUMENT AMPLIFYING THE REASONS RELIED ON

In its Ruling on the Loss Carry-overs the Court of Appeals has Decided an Important Question of Federal Law which has not been but Should be Settled by this Court.

The first and most important Federal question presented by this case is whether or not a prior operating loss of a corporation will carry over for tax purposes where there is an intervening Chapter X reorganization in bankruptcy.

It is submitted that the decision of the Court of Civil Appeals on this question is in error. It is of controlling importance to the question that Gulf Southwestern Transportation Company was in fact the same corporation after as before the reorganization decree. The "conceptually" new taxpayer created by the Court's opinion is a whole cloth legal fiction. Gulf Southwestern was chartered as L. T. Campbell Trucking Company on the 20th day of August, 1945, by L. T. Campbell, Jr., and others (Government's Ex. 8; R. 48). Its name was changed to Gulf Southwestern Transportation Company by charter amendment on November 29, 1947. The company was so operated to the date of its sale to Petitioner. The selfsame corporation was operated by Petitioner as Gulf Southwestern Transportation Company after he acquired its stock. All this was shown by the Government's Exhibit No. 8. The opinion of the Court of Appeals in fact acknowledges "an uninter-

rupted corporate existence under the state charter" (Pg. 9).

In view of the continued corporate existence of Gulf Southwestern as acknowledged, such minor changes as occurred in reorganization of its affairs should be wholly beside the point. Furthermore, all such changes were typical and normal in the circumstances. The company was in financial distress. In a related transaction Petitioner bought the company stock and the consideration which he paid went to company creditors, in full payment of some classes and in settlement of others. As would be expected, Petitioner took over management as the new stockholder and president. It should be observed that the corporation never ceased to function as a motor carrier. In fact, under its state and interstate operating certificates operations before and after the reorganization necessarily were identical.

The Court of Appeals has regarded as significant the cancellation of a minority of the outstanding stock by the bankruptcy decree. The decree, however, recited that the corporation was insolvent and that there was no stockholders' equity. The cancellation obviously was for the purpose of effecting a transfer by the majority stockholder pursuant to the reorganization plan. It had no other significance, and there were no other changes of any kind in the corporate structure.

In refusing to allow the loss carry-over on these facts the Court of Appeals is at variance with this Court's plainly expressed understanding of the law in *New Colonial Ice Co., Inc. v. Helvering*, 292 U.S. 435. In that case this Court held that there could be no carry-over where there was a transfer of assets from one corporation to another. The Court said that on the facts before it the new cor-

poration was not the same taxpayer. It plainly indicated, however, that loss would carry forward but for the transfer of assets to the new corporation. All legal writings are consistent with the principle of the *New Colonial* case and contrary to the holding of the Court of Appeals in their view that losses will carry forward through a recapitalization where not precluded by a disruption of the bankrupt's corporate entity. One writer expressed it thus:

> "In view of the fact that the corporation involved in the Chapter X proceeding is generally one that has previously sustained losses, the availability of these losses as a net operating loss carry-over under Code Sec. 122 is of extreme importance. Here exists probably the greatest difference in federal income tax treatment between the recapitalization of the same corporation and the formation of a successor corporation in a Chapter X proceeding. In the former case, the net operating loss of the preceding years is available as a carry-over under Code Sec. 122, whereas in the latter case, the net operating loss of the old corporation is unavailable to a new corporation." ("Chapter X Reorganizations as Affecting the Net Operating Loss Deduction," by Solomon S. Mandell, from "Taxes, The Tax Magazine," November, 1950, pg. 1959.)

See also Harvard Law Review, Vol. 57, pg. 1042; "Some Tax Considerations Affecting the Design of a Chapter X Reorganization," by Don Steger Harnack, 37 Marquette Law Review 130; and "Tax Considerations in Reorganization of Insolvent Corporations," by Thomas N. Tarleau, 57 H.L.R. 1009, pp. 1042-1043. Legislative understanding of the matter is precisely the same. See House Committee on Ways and Means in House Report No. 624, June 20, 1947, 80th Congress, First Session, pg. 1297. Cases involving separate corporations have gen-

erally cited and followed the rule of *New Colonial. (Follansbee Steel Corp. v. U. S.*, 109 F. Supp. 635; *Donahue v. U. S.*, 112 F. Supp. 660; *Lisbon Shops, Inc. v. Koehler*, 353 U.S. 382.) In *New Market Manufacturing v. U. S.*, 233 F. 2d 493, which involved a merger of one corporation into another for the sole purpose of effecting a change of domicile, this Court by denial of certiorari permitted a loss carry-over to the new corporation (352 U.S. 960).

In ascribing the creation of a "conceptually new taxpayer" as a consequence of reorganization, the Court of Appeals is squarely at variance with the bankruptcy laws. The Bankruptcy Act, Title 11, Chapter X, Sections 668 and 670, deals specifically with the tax consequence of discharge of indebtedness pursuant to a bankruptcy decree. Section 668 provides that no income accrues by reason thereof, and 670 provides that the taxpayer's property basis is adjusted, subject to market value as a minimum, to the extent that its indebtedness is discharged. Obviously if the effect of reorganization of a company were to constitute it a new taxpayer, there would be no need for these sections. It is further submitted that under them the only tax consequence intended by the Legislature to result from discharge of indebtedness is as there specified. This consideration was urged to the trial court, then by initial brief and by motion for rehearing to the Court of Appeals, but it has been ignored completely.

In its holding that Petitioner's acquisition of the corporate stock of Gulf Southwestern constituted that company a new taxpayer, the Court is also at variance with legislative intent as it is expressed in I.R.C. Section 129. That section provides that acquisition of ownership of a company precludes carry-over to the extent only that such

acquisition is for the purpose of evasion of taxes. There has not been a suggestion that the acquisition of Gulf Southwestern by Petitioner was prompted by motives of tax evasion or avoidance. In fact, as the Court of Appeals points out, the tax returns of Gulf Southwestern for 1950 and thereafter erroneously showed 11/20/50 as its incorporation date. Loss carry-forward was not even claimed in early operations under Petitioner's ownership.

It is believed that the error in the Court of Appeals opinion on a question of Federal law is plain enough. The question in and of itself as here presented, as to the right to carry-over loss through reorganization under the 1939 Internal Revenue Code and the bankruptcy laws, is of basic importance and should be settled by this Court. It is important also that the Court of Appeals decision cannot be confined to the question thus stated. The Court has decided that it can create a fictitious new taxpayer. There are numerous situations in the 1939 Code and other revisions which necessarily will be affected by that treatment of the question in this case. As was observed in the "Taxes" article heretofore cited, the problem of a "new" taxpayer can raise tax questions in numerous situations; e.g., in the case of availability of unused dividends paid credit to "the taxpayer", *Jones v. Noble Drilling Co., Inc.*, 135 F. 2d 721 (C.A. 10th, 1943); future deductions for unamortized bond discount on bonds continuing to remain outstanding, *Helvering v. Metropolitan Edison Co.*, 306 U.S. 522 (1939); *General Gas & Electric Corp. v. Comm'r.*, 306 U.S. 530 (1939); Note (1943) 56 Harv. L. Rev. 1308; deductibility of the debtor's taxes and interest theeron, *Magruder v. Supplee*, 316 U.S. 394 (1942); *Koppers Co.*, 3 T.C. 62 (1944); taxability of processing tax refunds, *Michael Carpenter Co. v. Comm'r.*,

136 F. 2d 51 (C.C.A. 7th 1943); capacity and procedure to contest federal income tax claims and the running of the statute of limitations, Int. Rev. Code Sec. 311; stockholders' ability to identify shares, *Crespi v. Comm'r.*, 126 F. 2d 699 (C.C.A. 5th, 1942); and numerous others.

In short, the Revenue Code is filled with references to "the taxpayer", and in every such instance the possibility of creation of a new taxpayer by judicial pronouncement as in this case, will raise a question of status under existing law. The broad question thus raised should also be settled.

> In its Ruling on the Carry-Backs the Court of Appeals has Rendered a Decision which is in Conflict with Decisions of this Court and with the Ruling of Another Court of Appeals on the Same Subject.

There are two essential elements to conviction of willful attempt to evade income tax under I.R.C. 1939, 1945(b): (1) an affirmative and willful attempt to evade, and (2) the existence of a tax liability in excess of that reported. *(Davis v. U. S.*, 226 F. 2d 331, 334 (6th Circuit, 1955, cert. denied 350 U.S. 965)); *Elwert v. U. S.*, 321 F. 2d 928 (9th Circuit, 1956); *Pinkoff v. U. S.*, 86 F. 2d 868 (cert. denied 301 U.S. 689); *U. S. v. Manno*, 18 F. Supp. 511 (D.C. Illinois, 1954); *Small v. U. S.*, 255 F. 2d 604, 606 (1st Circuit); *Clark v. United States*, 211 F. 2d 100); I.R.C. 1954, Title 26, Sec. 172(b)(1)(A), provides:

> "(b) Net operating loss carrybacks and carryovers—
>
> (1) Years to which loss may be carried.—A net operating loss for any taxable year ending after December 31, 1953, shall be—
>
> (A) a net operating loss carryback to each of the

> 2 taxable years preceding the taxable year of such loss, . . ." (I.R.C. 1954, Tit. 26, Sec. 172(b)(1)(A))

Evidence was offered on behalf of Petitioner which, without the aid of carry-over losses from prior years, would carry back under the above provision and result in an overpayment of tax for the year 1953. The evidence was excluded by the Court on the dictum in *Spies v. U. S.*, 317 U.S. 491, to the effect that the crime of attempt to evade income tax is complete when the return is filed. Spies involved a charge to the jury on facts not even remotely similar to this case. It did not involve a loss carry-back or a tax year for which there was no tax due. This language cannot prevail over decisions squarely in point which hold that tax liability must be proved before there can be a crime of attempt to evade. The ruling of the Court of Appeals is in conflict on principle with the decisions above cited and with dictum in *Elwert v. U. S.*, 231 F. 2d 928 (9th Circuit, 1956), wherein the Court said:

> "To convict one of violating Section 145(b), the government must prove that there was a tax owed to it by the defendant (footnote), ... Elwert contends that if the overstatement of his income in 1949 and the deductions to which he was entitled, but did not claim, in the years in question were taken into account, there would be no liability for 1947, 1948, and 1949, ... If this were true, the unreported income for 1949 could be wiped out, and because of the carry-back provisions of 26 U.S.C. 122, the amount of taxable income for 1947 and 1948 could be affected."

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Dated June 26, 1961

Respectfully submitted,

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APPENDIX A

Revenue Act of 1950

§215. NET OPERATING LOSS DEDUCTIONS

(a) Allowance of five-year carry-over.—Section 122(b) (relating to the amount of carry-backs and carry-overs) is hereby amended to read as follows:

"(b) Amount of carry-back and carry-over.—

* * * *

"(2) Net operating loss carry-over.—

* * * *

"(B) Loss of taxable year beginning after 1949.—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for each intervening taxable year, without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c). For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1949, shall be reduced by the amount, if any, of the net income for the preceding taxable year computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for such preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c)."

(b) Effective date of subsection (a).—The amendment made by subsection (a) shall be applicable in computing the net operating loss deduction for taxable years beginning after December 31, 1947. Historical notes and notes of decisions, see 26 U.S.C.A., § 122.

Revenue Act of 1951

Sec. 330. NET OPERATING LOSS CARRY-OVER

* * * *

(b) Allowance of three-year loss carry-over from taxable years 1948-1949.—Section 122(b) (2) (relating to the amount of carry-over) is hereby amended by adding after subparagraph (B) the following new subparagraphs:

"(C) Loss for taxable year beginning after December 31, 1947, and before January 1, 1950.—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

"(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(ii) by determining the net operating loss deduction for each intervening taxable year without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c). For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1947, and before January 1, 1950, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

"(iii) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

"(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c)."

U.S.C.A., Title 11, Chapter 10

§668. Same; income or profit from modification of indebtedness

Except as provided in section 670 of this title, no income or profit, taxable under any law of the United States or of any State now in force or which may hereafter be enacted, shall, in respect to the adjustment of the indebtedness of a debtor in a proceeding under this chapter, be deemed to have accrued to or to have been realized by a debtor, by a trustee provided for in a plan under this chapter, or by a corporation organized or made use of for effectuating a plan under this chapter by reason of a modification in or cancellation in whole or in part of any of the indebtedness of the debtor in a proceeding under this chapter. July 1, 1898, c.541, §268, as added June 22, 1938, c.575, §1, 52 Stat. 904.

§670. Same; income tax property basis adjustment.

In determining the basis of property for any purposes of any law of the United States or of a State imposing a tax upon income, the basis of the debtor's property (other than money) or of such property (other than money) as is transferred to any person required to use the debtor's basis in whole or in part shall be decreased by an amount equal to the amount by which the indebtedness of the debtor, not including accrued interest unpaid and not resulting in a tax benefit on any income tax return, has been canceled or reduced in a proceeding under this chapter, but the basis of any particular property shall not be decreased to an amount less than the fair market value of such property as of the date of entry of the order confirming the plan. Any determination of value in a proceeding under this chapter shall not be deemed a determination of fair market value for the purposes of this section. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe such regulations as he may deem necessary in order to reflect such decrease in basis for Federal income-tax purposes and otherwise carry into effect the purposes of this section. July 1, 1898, c.541, §270, as added June 22, 1938, c.575, §1, 52 Stat. 904, and amended July 1, 1940, c.500, §1, 54 Stat. 709.

Internal Revenue Code of 1939

§129. Acquisitions made to evade or avoid income or excess profits tax

(a) Disallowance of deduction, credit, or allowance. If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

§145. Penalties

* * * *

(b) Failure to collect and pay over tax, or attempt to defeat or evade tax. Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

U.S.C.A., Title 26, Chapter 1

§172. Net operating loss deduction

* * * *

(b) Net operating loss carrybacks and carryovers.—

(1) Years to which loss may be carried.—A net operating loss for any taxable year ending after December 31, 1953, shall be—

(A) a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, . . .

APPENDIX B

Opinions and Judgments Below
Court of Appeals Opinion

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 18,381

A. C. WILLINGHAM, *Appellant*
versus
UNITED STATES OF AMERICA, *Appellee*

Appeal from the United States District Court for the Southern District of Texas

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(April 20, 1961.)

Before TUTTLE, Chief Judge, BROWN, Circuit Judge and CLAYTON, District Judge.

TUTTLE, Chief Judge: This appeal from a conviction in a prosecution for an attempt to evade income tax presents the question whether the trial court erred in preventing the accused from showing that no taxes were due for the two prosecution years. The appellant does not here contest the sufficiency of the evidence to

sustain a jury's verdict of guilty, based on undisputed testimony that he had wilfully set up fictitious expense deductions on the books of the company of which he was president, unless he is to be permitted to reconstruct the income for the years 1952 and 1953. There was undisputed evidence that the false and fictitious entries resulted in defeating the government in collecting part of the tax shown on the return to be due during these years.

What the appellant does assert is that he was entitled to prove that the true tax liability of the corporation for the years 1952 and 1953 should be arrived at by reconstructing the return for these years after giving effect to substantial loss carry-overs from the years 1949 and 1950. The record does not disclose that any effort had been made by the corporate taxpayer to take advantage of these carry-overs during such period of time as this might have been done before the tax liability for the respective years was finally fixed by the applicable statutes of limitations.

The government's principal reliance in objecting to proof tendered by appellant below of the amount of loss carry-overs is that these loss carry-overs are not available to appellant's corporation because the government says the corporation is "not the same taxpayer" as that which suffered the losses because the corporation went through a Chapter X Bankruptcy Act reorganization subsequent to the losses sought to be carried forward.

For several years prior to November 20, 1950, Gulf Southwestern Transportation Company, Inc., was engaged in the business of a truck carrier operating under a certificate of public convenience and necessity issued

by the Interstate Commerce Commission. We take it as true for the purpose of this appeal that during the years 1949 and 1950 it suffered substantial losses, as it had in prior years. This resulted in the filing of a petition for reorganization in the bankruptcy court by the corporation. This was followed by the filing of a plan of reorganization which was finally accepted and made operative by an order of the District Court, November 20, 1950. Under this plan of reorganization, the corporate shell remained and its I.C.C. certificates continued to be effective although its capital structure was somewhat modified in that the plan called for the surrender of the stock by minority stockholders and the retention by one Culbertson of his stock; this stock was to be purchased by A. C. Willingham, the appellant here. Willingham was to pay a sum which Culbertson agreed would be used to pay certain preferred claims against the corporation and to pay a percentage of other claims, including the United States Government's claim for taxes and to pay 10% on the claims of ordinary unsecured creditors. This, of course, amounted to a donation to capital. All other debts of the corporation were wiped out under the plan of reorganization. There was a further partial modification of the capital structure of the corporation in the provision in Willingham's contract to purchase the stock which required him to "cause" the corporation "to assign to Culbertson . . . 5% of the gross revenues of such corporation", such amount to represent a minimum payment which Willingham agreed to make in payment of the purchase price for the stock. It is to be noted that this payment was to be made whether or not there were any profits in the operation, and thus

were to be made even though they impaired the capital of the corporation.

Willingham was elected President and took complete charge of the corporation's operation. The corporation's income tax return for the period of November 20 through December 31, 1950 showed a loss of $736.93. The corporation income tax return for the entire calendar year 1950 showed a loss of $28,490.87, of which $27,753.94 represented losses incurred prior to the reorganization. Proof offered by the appellant was to the affect that the 1949 operation showed a net loss of $46,079.36. It was the taxpayer's contention that this figure could, under existing provisions of the 1939 Internal Revenue Code be carried forward to 1952, and when this was done it would wipe out completely any income for that year. Then, by carrying forward the net loss of $28,490.87 of 1950 to the year 1953, this would also eliminate any deficiency in taxes for that year.

When the appellant sought to tender evidence touching on the net loss for the years 1949 and 1950, prior to the reorganization, government counsel objected on the ground that these net losses could not be applied to determine the tax liability of the corporation resulting from its operations subsequent to the reorganization. The trial court sustained this objection, but by agreement with counsel provided a means by which a proffer of proof could be made in order that the correctness of the court's ruling could be adequately presented on appeal.[1]

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[1] The trial court said in this connection:

> "The defendant has offered the 1950 income tax return, or more accurately, you have offered your own retained copy of the income tax return for Gulf Southwestern Transportation Company for 1950. The govern-

It is undoubtedly true, as the trial court held in this case, that conviction under Section 145(b) of the Internal Revenue Code of 1939, 26 U.S.C.A. (Internal

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ment contends that it is irrelevant and not admissible for that reason. Defense contends that it reflects a loss of some $28,000.00 which might be carried forward and taken advantage of in 1952 by Gulf Southwestern Transportation Company, on the theory that if that $28,000.00 loss were carried forward, it would reflect that in truth no tax was due by the corporation for 1952, hence your client as president of the corporation, could not have been guilty of attempting to evade taxes when in fact there were no taxes due by the corporation for 1952.

* * * *

So, recognizing your right to raise the point that there were no taxes due by the corporation in 1952, we come to the next question, as to whether the loss carry over from 1950 is a proper means of doing so, and it is there that I think your position I am speaking to the defense attorneys at the moment is not well taken, because I am of the view that the corporation in 1952, following the corporate reorganization, is not the same taxpayer in contemplation of the statute, so as to permit the loss to be carried forward. * * *

"* * * The proceeding was in Bankruptcy Court of the Northern District of Texas for several months, and a plan of reorganization was ultimately agreed to by all of the creditors, approved by the Court, and was put into operation. What the plan was as reflected by the instrument which you all have shown me and have offered in evidence. It was substantially that Culbertson acquired all of the stock of the corporation and, by order of the Court, what he didn't acquire was canceled.

"He and the defendant here, Willingham, entered into an agreement contemporaneously with and as a part of the plan of reorganization, whereby Willingham would buy all of the corporate stock from Culbertson, and in fact did so. All of the debts of the corporation were released under the Bankruptcy statutes, the creditors, of course received a reduction in the claims which they had against the corporation, one of which, as we noted in our conference, was the collector of Internal Revenue and, having been released of its old debts and set again

Revenue Code of 1939 as amended) 145(d) cannot be supported in the absence of a showing that the government was due a tax in excess of that reported. *Koontz v. U. S.*, 5th Cir. 277 F. 2d 53. As stated in Mertens Law of Federal Income Taxation, Section 55, 37:

> "A prosecution for wilful failure to file a return may be maintained where there is no tax due. But no prosecution for wilful attempt to evade or defeat a tax is possible unless there is some tax due."

The government does not contest the correctness of this proposition. It says that on the record here before the court there is no evidence or proffer of proof which would permit a jury to find that the tax due by the corporation is anything other than as reported in its income tax returns for 1952 and 1953 as modified by the proven falsities touching on the fictitious deductions.

The parties present a difficult question when they ask whether a corporation whose debts have all been wiped out by a Bankruptcy Act reorganization is nevertheless "the same taxpayer" which the terms of the carry-over provision of the Internal Revenue Code say can carry forward the losses which created the forgiven

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upon a new path, the corporation was operated thereafter by Mr. Willingham as its sole stockholder.

"That presents us with the question as to whether the corporation, still operating under the same charter but having been reorganized under Section 77 b, having its debts forgiven and starting over again under complete change of ownership and management, is the same taxpayer as the term "the same taxpayer" is used in Section 122 of the 1939 Code, which gives the right, in some instances, of a tax loss carry-over."

debts in order to wipe out income for tax purposes in future years.

The appellant strongly relies on *New Colonial Ice Co., Inc. v. Helvering*, 292 U.S. 435 where in a reorganization proceeding, a new corporation took over the business and the court held that this new corporation was not the same taxpayer and was not entitled to the loss carry-over under a somewhat similar earlier statute. Appellant stresses particularly the language of the Court, "Its words are plain and free from ambiguity. Taken according to their natural import, they mean that the taxpayer who sustained the loss is the one to whom the deduction shall be allowed." The appellant points out that in the present case this is unquestionably the same corporate person that sustained the loss prior to reorganization and the case thus fits neatly within the language of the act as applied by the Supreme Court. Of course, there the taxpayer sought to carry the loss over from one corporation to a new corporate entity which was alleged to be in substance the same taxpayer. In denying the right to do so, the court used the language quoted above. Here, the contention is made that, even though greatly changed in substance following the tax loss years the identity of the corporate entity after the reorganization with that before satisfies the requirement.

The government contends that conceptually this is not the same taxpayer, because, although the corporate shell remains the same, the structure is entirely different and the new sole owner of the entire stock of the company has so identified himself with the corporate taxpayer, both by the obligation he undertook touching on the withdrawal of funds from the company, regard-

less of income, and because of his complete domination and management, as to make it in substance, though not in form, a separate taxpayer. Principal support for the government's theory is found in *Libson Shops, Inc. v. Koehler*, 353 U.S. 382, in which the "continuity of a business enterprise" is made the test. In Libson the court found it unnecessary to decide whether the corporate identity principle controlled, because the court found that there was a lack of continuity of a single business enterprise. There the post-merger corporation which has been the parent of sixteen separate operating companies sought to carry forward losses suffered by three of the operating companies to offset profits earned subsequent to the merger. To be sure, the taxpayer corporation was not the same corporation that had suffered the losses, and in that respect is different from the Transportation Company here.

This Court, in *Mill Ridge Coal Co. v. Patterson*, 5 Cir., 264 F. 2d 713, applied the same test of "continuity of business enterprise" in the case of a single corporate taxpayer that disposed of its assets and after change of ownership of the stock engaged in a new type of business: oil distribution as against coal mining. We held there "that the taxpayer here, as in the Libson case, supra, is not the 'taxpayer' within the meaning of 26 U.S.C.A. §122(b)(2)(C)."

In the case before us we have, instead of a complete reorientation of business activity, substantially the same kind of business carried on, but by a corporation having entirely new stock ownership and with an entirely new corporate structure. Its debts have been wiped out, by the adoption of the plan provided for

under the Bankruptcy Act, and its only assets are saved for it by and agreement of the sole stockholder to pay into the corporation the sums necessary to pay the mortgage holders and state and county in full, the federal government in part and 10% to unsecured creditors. Its structure is further modified by the agreement under which the stock was sold to Willingham. He was to pay to the remaining single stockholder Culbertson enough to reimburse Culbertson for the obligations just enumerated, and he pledged 5% of *gross revenues* of the corporation to secure the payment of the purchase price. This, thus, left the corporation's new reconstituted capital subject to being depleted if operating profits did not yield the 5% of the gross revenues which Willingham was obligated to pay.

We think that in every sense of the word except for the uninterrupted corporate existence under the state charter, the taxpayer that commenced operations on November 20, 1950, was as it stated in its own income tax return[2] a new business enterprise. The complete identification of the single stockholder with the corporation, by his personal undertaking to pay off the creditors (to the extent to which they were paid at all) and his pledge of 5% of gross income of the future operations whether or not earned made of this corporation after reoganization a completely different corporate person than when it was incurring the losses here sought to be carried forward. It, therefore, does not fit into the scheme which Congress had in mind

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[2] On each of its income tax returns filed through 1955, the corporation entered as date of incorporation "11-20-50". In the first such return it was also stated, "Reorganization in bankruptcy."

when it passed the carryover law, "designed", as the Supreme Court said in Libson, to "permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income over a period longer than a year." 353 U.S. 385. This loss taxpayer "set off its lean years" by having them wiped out in reorganization proceedings. We cannot believe it could thereafter utilize the same losses to minimize its taxes to the United States, part of whose claim for income taxes had been discharged in the reorganization proceedings.

We conclude therefore that on the undisputed facts tendered by Willingham's proffer of evidence to show that there was no tax due for 1952 and 1953, evidence of losses incurred in 1949 and 1950 was not admissible.

We next come to the claim that a loss sustained in 1955 should have been carried back to 1953, and that if this had been done no tax would be due for that year. This would not affect the 1952 conviction, but would be a defense to the 1953 charge. Whatever problems there might be as to loss carry-overs, there can be no difficulties as to loss carrybacks.[3] They operate retrospectively to reduce or extinguish a tax previously due. In an analogous situation imposing the 50% civil penalties on the whole of the initial deficiency with no reduction from the loss carryback allowed, the Eighth Circuit had this to say:

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[3] This basic distinction is recognized by tax writers. See Gutkin, Tax Law Violations and Enforcement: The Handling of Penalty Cases, Proceedings of New York University, Sixth Annual Institute on Taxation, 1948, 189 at 203-4; and Gilman, Current Problems in Criminal Tax Fraud, 33 Taxes 749, 752 (1955); Balter, Fraud Under Federal Tax Law, pp. 319-51 (2 ed. 1953).

> "The tax for 1943 became due and payable on the date the taxpayer was required to file her 1943 return, and the penalties became due and payable on the same date. The carryback provision does not relieve the taxpayer of the obligation to pay the tax in full when it falls due, and can not be interpreted as deferring taxpayer's duty to pay the tax promptly. Manning v. Seeley Tube & Box Co., 338 U.S. 561, 70 S. Ct. 386, 94 L. Ed. 346. In the case just cited the Court held that where a deficiency and interest have been assessed, a subsequent carryback loss which abates the deficiency does not abate the interest assessed. The reasoning of the Manning case supports the fraud and delinquency penalties here determined. The decision upon this issue also finds support in other cases. See C. V. L. Corporation v. Commissioner, 17 T.C. 812; Auerbach Shoe Co. v. Commissioner, 21 T.C. 191, affirmed, 1 Cir., 216 F. 2d 693; Nick v. Dunlap, 5 Cir., 185 F. 2d 674; Petterson v. Commissioner, 19 T.C. 486." *Simon v. Commissioner*, 8 Cir., 1957, 248 F. 2d 869 at 877.

As this quotation reflects, this Court has taken a like view. *Nick v. Dunlap*, 5 Cir., 1950, 185 F. 2d 674.

A taxpayer may not, with impunity, wilfully make false deductions in an attempt to evade the 1953 tax, and which has the actual effect of reducing the tax imposed for that year, after taking into account all deductions that are then available, whether claimed or not, because fortuitously in 1955 a loss occurs, which for tax purposes can be carried back to wipe out the 1953 liability.

We think the crime is complete, when with wilful intent, a false and fraudulent return is filed for a year as to which, with all benefits arising out of events up to that time taken in his favor, there would still be a tax due by him but for the fraud. Such tax is, in our opinion, the "tax imposed by this chapter." Any adjustment that may be permissible resulting from subsequent losses does not prevent the fraud committed in 1953 form being an attempt "to evade or defeat a tax imposed by this chapter." See *Spies v. U. S.*, 317 U.S. 491 and *Goo v. U. S.*, 9 Cir., 187 F. 2d 62, cert. den. 341 U.S. 916.

We conclude, therefore, that the carry-overs from 1949 and 1950 were not available to effect the tax liability of Southwestern after reorganization in 1950. Thus the proffered testimony touching on them was irrelevant. We also conclude that the 1953 offense was complete when the tax return for that year was filed, and it could not be undone by subsequent year's tax consequences. The trial court therefore properly rejected the proof touching on these matters.

The judgment is AFFIRMED.

Test: EDWARD W. WADSWORTH
Clerk, U. S. Court of Appeals, Fifth Circuit

By CLARA R. JAMES
Deputy

New Orleans, Louisiana June 20, 1961

COURT OF APPEALS JUDGMENT

Judgment

Extract from the Minutes of April 20, 1961.

A. C. WILLINGHAM,

No. 18,381. versus

UNITED STATES OF AMERICA

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

* * * *

Court of Appeals Opinion on Petition for Rehearing

In The
UNITED STATES COURT OF APPEALS
For The Fifth Circuit

No. 18381

A. C. WILLINGHAM, Appellant,
versus
UNITED STATES OF AMERICA, Appellee.

Appeal from the United States District Court for the Southern District of Texas
Southern District of Texas

(June 2, 1961)

ON PETITION FOR REHEARING

BEFORE TUTTLE, Chief Judge, BROWN, Circuit Judge, and CLAYTON, District Judge.

PER CURIAM: The appellant calls our attention to an inaccuracy in our opinion that we think should be corrected. In the second sentence in the opinion the word "undisputed" is stricken out before the word "testimony."

In addition, upon carefully restudying the opinion, it appears that two comments that were made in the opinion are not strictly relevant to the decision or the reasoning of the Court in arriving at it. We, therefore, strike the following sentence from page 2 of the opinion:

> "The record does not disclose that any effort had been made by the corporate taxpayer to take advantage of these carry-overs during such period of time as this might have been done before the tax liability for the respective years was finally fixed by the applicable statutes of limitations."

We also strike the following sentence on page 10 of the opinion:

> "We cannot believe it could thereafter utilize the same losses to minimize its taxes to the United States, part of whose claim for income taxes had been discharged in the reorganization proceedings."

The motion for rehearing is DENIED.

The motion for reheari

. WADSWORTH
A true copy of Appeals, Fifth Circuit.
Test: EDWARD W.
Clerk, U. S. Court By CLARA R. JAMES, Deputy
(Seal)
By
New Orleans, Louisiana * * * *
June 20, 1961

* NYING REHEARING

ORDER DEN e Minutes of June 2, 1961.

Extract from the WILLINGHAM
versus
A. C. W TATES OF AMERICA
No. 18381.

UNITED STA ourt that the petition for rehearing
d the same is hereby, DENIED.

It is ordered by the Cou
filed in this cause be, and * * * *

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JUDGMENT AND COMMITMENT

Filed May 10, 1960

United States District Court for the Southern District of Texas, Houston Division

United States of America,
v. No. Cr. 13701
A. C. Willingham

On the 9th day of May, 1960 came the attorney for the government and the defendant appeared in person and with counsel

It Is Adjudged that the defendant has been convicted upon his plea of not guilty, and a verdict of guilty of the offense of attempting to evade and defeat corporate income taxes, in violation of Title 26, U. S. Code, Section 145(b), Internal Revenue Code of 1939, as charged and the Court having asked the defendant whether he has anything to say why judgment should not be pronounced, and no sufficient cause to the contrary being shown or appearing to the Court,

It Is Adjudged that the defendant is guilty as charged and convicted.

It Is Adjudged that the defendant is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for a period of Thirty-Six (36) Months on Count 2 and Thirty-Six (36) Months on Count 1, concurrent with the sentence imposed on Count 2.

It Is Further Adjudged that the defendant is hereby fined the sum of Five Thousand ($5,000.00) Dollars on Count 2.

It Is Adjudged that in default of payment of the fine, execution may issue.

It Is Ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer and that the copy serve as the commitment of the defendant.

BEN C. CONNALLY,
United States District Judge.

Done the 10th day of May, 1960.

The Court recommends commitment to:

Approved:

R. F. WHELESS, JR.